

Ofgem's Approach to requests for contract amendments

1. Introduction

- 1.1 Ofgem has been reviewing the approach we take to discharging Ofgem's statutory duties with regard to payment of the Fossil Fuel Levy in the context of NFFO/SRO contract amendments. In order to assist NFFO/SRO contract holders with regard to such changes Ofgem has decided to set out the principles which we will be applying to do so. Ofgem will apply these principles in determining whether electricity from a particular NFFO/SRO project qualifies for support out of the Fossil Fuel Levy (FFL). This review has also been prompted by the introduction of the Renewables Obligation, the "new arrangements" under the Saving Arrangements Orders and by queries in relation to a number of specific projects in that context.
- 1.2 Paragraphs 2 - 4 below set out the approach which we consider it appropriate to adopt. We have discussed this approach with DTI and the Scottish Executive. We will be applying this approach from now on subject to any substantive comments received. However, we recognise that it is not possible to anticipate every eventuality. Whilst in general we would expect to decide on particular cases in accordance with the principles set out below, we will continue to take due account of all of the facts and circumstances of each case.
- 1.3 Ofgem believes this approach, whilst complying with our statutory duties in respect of FFL, also represents increased certainty for all parties involved.

2. General Principles

- 2.1 Under the FFL Regulations and the FFL (Scotland) Regulations, Ofgem is the prescribed person for setting the rate of FFL, collecting FFL from licensed suppliers and distributing FFL to NFFO in England and Wales and to NFFO Scotland in Scotland. The rate of FFL must be set so as to cover the likely cost of payments out of FFL to NFFO/SSCs plus Ofgem's administrative expenses in administering the FFL.
- 2.2 Payments out of FFL are made according to a formula. Both under the FFL Regulations and under the FFL (Scotland) Regulations, the key to this calculation is that FFL is to be paid in respect of electricity generated "pursuant to" qualifying arrangements ("QAs"). QAs are defined by Section 33(7A) of the Electricity Act (EA) 1989 as being "new arrangements" ("NAs") under the relevant Saving Arrangements Order, which meet prescribed conditions in respect of locational flexibility¹. Essentially, therefore, Ofgem must pay FFL in respect of given electricity in any period if (a) the relevant NFFO/SRO contract constitutes NAs, and (b) the electricity is generated "pursuant to" that contract. If either of these conditions is not fulfilled, Ofgem must not pay FFL in respect of that electricity. And if either of those conditions is likely to remain unfulfilled, then Ofgem's review of the rate of FFL must disregard future electricity from that project.
- 2.3 Our approach must cover the following scenarios, which we address in turn below:-

¹ Section 33(7A)-(7D) EA1989 as inserted by the Locational Flexibility Orders.

- (A) pre-Saving Arrangements Order NFFO/SRO contract amendments;
- (B) post-Saving Arrangements Order NFFO/SRO contract amendments; and
- (C) "as-built" divergences from the relevant contract.

3. Pre-Saving Arrangements Order NFFO/SRO contract amendments

3.1 We view these amendments as having been "blessed" by the relevant Saving Arrangements Orders, provided that:-

- (A) the contract amendments in question formed part of the arrangements presented to Ofgem by the date prescribed in the relevant Order, and
- (B) those arrangements, as amended, satisfied the definitions of NAs in the Order².

3.2 As to their being presented, arrangements (including replacement NFFO contracts) were presented on behalf of the PESs by the prescribed date in each case. In England and Wales, they were then re-presented on behalf of the SSCs in England and Wales. Any prior contract amendments were expressly incorporated (a) in England and Wales by an express provision in the replacement contracts presented by NFPA, and (b) in Scotland, by the fact that the SRO contracts were simply assigned to the SSCs.

3.3 As to their satisfying the definition of the NAs in the relevant Order:-

(A) in England and Wales, this definition required the arrangements (a) to "replace" the existing NFFO arrangements, with NFPA in place of the PESs; (b) to secure (subject to the ratchet) the same capacity from the same technology bands as was previously required under the NFFO Orders; and (c) to be on the same economic terms in specific respects (ie contract price, indexation and term). We note that the Secretary of State implicitly confirmed that these criteria were satisfied when he released the PESs from their NFFO Order obligations;

(B) in Scotland, the definition required the arrangements (a) to "replace" the existing SRO arrangements with the SSCs replacing the PESs, and (b) to secure (subject to the ratchet) the same capacity from the same technology bands as was previously required under the SRO Orders². There was no provision for the Secretary of State to confirm his acceptance that these criteria were satisfied.

3.4 Accordingly, Ofgem proposes to treat each of the contracts presented under the Saving Arrangements Orders (and re-presented under the Saving Arrangements (Amendment) Order in England and Wales), and which fulfilled the criteria in 3.3 above as being QAs as at the date on which those arrangements took effect. That date is 1 October 2001. Any subsequent changes are dealt with below.

² The Order placed economic requirements on the NAs, but these were not incorporated into the definition of NAs (although this point is not material for Ofgem's approach).

- 3.5 We propose to treat it as irrelevant whether the contract amendment was notified to and/or approved by Ofgem when originally made. However, going forward, we would expect to be notified of future contract amendments.
- 3.6 If the Saving Arrangements Orders have “blessed” pre-existing contract amendments for the purposes of FFL payments going forward, we do not consider them to have done so retrospectively. That is, if a contract was amended in 1999, unbeknown to Ofgem, in a way which meant that it ceased to be QAs in 1999, the relevant Saving Arrangements Order cannot retrospectively undo that fact.

4. Post-Saving Arrangements Order NFFO/SRO contract amendments

- 4.1 Prior to the Saving Arrangements Orders, in considering whether a proposed NFFO/SRO contract amendment would prevent that contract from continuing to be QAs, Ofgem took the view that, by definition, QAs were arrangements evidenced by a particular date prescribed in the relevant NFFO/SRO Orders. Accordingly, Ofgem applied a test of whether the contract, as amended, would result in a project materially the same as the project contemplated by the contract as originally evidenced.
- 4.2 We propose to continue to apply this test, comparing future contract amendments to the NAs produced to Ofgem by the date prescribed in the relevant Saving Arrangements Order.
- 4.3 However, we propose to take our lead, as regards what is “material”, from the criteria adopted in the Saving Arrangements Orders, and from NFPA’s and the SSCs’ obligation, as the nominated person, “not by any act or omission of [theirs] to prevent those arrangements made by [them] from securing” the “aggregate amount of generating capacity which, immediately before the commencement of the order period, was required by those Orders to have been available...”.
- 4.4 Whether an arrangement which was originally a QA remains a QA after the contract it encompasses has been amended is a question of law and each case needs to be considered individually. On any particular case, only a court can give a definitive answer to the question. However, Ofgem, in taking a view on whether QAs which have been subject to contract changes remain QAs, will adopt a presumption that, unless the facts and circumstances of an individual case dictate otherwise, contract changes which satisfy the following criteria are acceptable. The criteria are that:-
- (A) any contract amendments existing at that date did not take the contract outside the relevant technology band;
 - (B) those contract amendments did not increase the Contractual Capacity ceiling on the commitment of the FFL in respect of that project (in any NFFO/SRO Order period or in aggregate) or extend the duration of that commitment; and
 - (C) those contract amendments did not entail a project so evidently technically or otherwise flawed that it would have failed the “will secure” test; and
 - (D) those contract amendments did not effect a reduction in the Capacity secured by the contract in any period or in aggregate, in circumstances not envisaged in the adapted conditions defined in Article 4(3) of the Saving

Arrangements Orders and where the NFFO/SRO ratchet would not reduce the capacity required to be secured, by the same amount³; and

- (E) those contract amendments did not in some other (perhaps more indirect) way affect NFPA/SSCs' ability to discharge their relevant obligations under the relevant Saving Arrangements Orders. For example, an increase in the installed capacity might in certain cases be expected to cause planning difficulties, leading to an avoidable delay in, or failure to secure, fulfilment of the Conditions Precedent, resulting in a failure to secure the full Contracted Capacity in at least some of the time periods specified in the relevant NFFO/SRO Order; and
 - (F) where applicable, the contract satisfies the requirements of the Locational Flexibility Orders.
- 4.5 We consider this to be consistent with the effect achieved by the Savings Arrangements Orders.
- 4.6 A contract amendment increasing installed capacity would only be agreed provided that the ceiling for premium payments would be unaffected. We will expect NFPA and the NFPA Scotland to ensure that the annual cap provided for in the contracts is implemented and that half-hourly metering is introduced where necessary to safeguard the FFL. A contract amendment decreasing contracted capacity for any reason outside the ratchet mechanism will not be agreed.
- 4.7 Whilst it will remain prudent for NFPA and NFPA Scotland to seek Ofgem's approval of any proposed amendments, we propose to treat it as irrelevant whether any such amendment is notified to and/or approved in advance by Ofgem. However, we would expect NFPA and NFPA Scotland to create a process whereby NFFO/SRO contract holders have to approach NFPA and NFPA Scotland with any proposed contract amendments.

5. "As-built" divergences

- 5.1 It would appear that not all "as-built" divergences from the original terms of the contract are reflected in contract amendments. Our proposed approach to such cases is as follows.
- 5.2 To qualify for FFL, as noted above, electricity must be generated "pursuant" to QAs. The mere existence of QAs, and generation of electricity and its sale to NFPA and NFPA Scotland does not of itself fulfil this requirement. For example, a generator would not be entitled to pass off electricity from a coal-fired or biomass generating station as having been generated "pursuant to" QAs which require the generation of electricity from wind at that location. We would not pay FFL in respect of such electricity.
- 5.3 Equally, however, Ofgem's view is that a non-material divergence of the as-built generating station from the exact terms of the QAs in question does *not* preclude that electricity from having been generated "pursuant to" those QAs. We propose to pay FFL in respect of such electricity.

³ We propose to view the "ratchet" as applying in respect of capacity reductions where, despite "Reasonable Endeavours" having been used to secure the full capacity, the reduced capacity is necessary to satisfy, so far as possible, the Conditions Precedent of the contract so as to allow the project to proceed at all.

- 5.4 It follows that Ofgem must apply a materiality test to such as-built divergences, and we propose to do so. The materiality test which we propose to apply is that described at 4.4 above for contract amendments. In other words, we propose to pay FFL in respect of electricity, where it is generated in a manner which departs from the terms of the relevant contract, but Ofgem would (if asked) have approved a contract amendment to reflect that manner of generation. This is because we would not consider this departure to be so material, that the electricity in question is not being generated pursuant to those QAs.
- 5.5 It is likely to be appropriate for Ofgem to carry out random checks.
- 5.6 Whilst "as-built" divergences from the NFFO/SRO contract prior to the relevant Savings Arrangements Order are not considered to have been "blessed" by the Saving Arrangements Orders, because they would not have been reflected in the NAs evidenced there under, Ofgem's proposed approach is to apply the materiality test described at 4.4 above to such divergences as from the date of commissioning.

6. Next Steps

Contact information

Florence Simon-Hart
Manager NFFO and Fraud Prevention

9 Millbank
London
SW1P 3GE

020 7901 7352

florence.simon-hart@ofgem.gov.uk